Irving Trust

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Economic Research &
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Friday
(Noon)

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The full implications of the Federal Reserve's recent tightening moves began to show through to the financial markets this week, as interest rates lurched sharply higher, with the Federal funds rate rising to the 20% area. The rate rise does not appear to signify a change in Fed policy as a result of the Federal Open Market Committee meeting this week. Rather, it reflects the somewhat delayed adjustment of the Federal funds rate to the higher discount and surcharge rates implemented at the beginning of this month, together with levels of net borrowed reserves that have averaged above $2 billion in recent weeks. Indeed, had not a probable Fed underforecast of reserve availability occurred in the statement week ending May 13, funds likely would have hit 20% a week ago. At the end of the week, the report of a smaller than expected increase in the consumer price index for April--4.8% at an annual rate--helped to pare back rates slightly.

It seems likely that this week's FOMC meeting largely reaffirmed the earlier policy stance with respect to provision of nonborrowed reserves to the banking system. In contrast, the minutes of the March 31 FOMC meeting, released Thursday afternoon, were crammed with interesting information and provided confirmation of many recent changes in Fed operating procedures which previously had only been surmised. Some of the highlights of the March minutes:

- No reference to M-1A was made in the directive to the System Account Manager. This simply confirms that the introduction of NOW accounts and other interest paying checkable deposits has made obsolete a narrow aggregate including only currency and traditional demand deposits. Moreover, the M-1B target is specified in terms of growth corrected for the upward bias imparted by shifts of funds from savings accounts to NOW accounts.

- Committee members appear to recognize that at least some portion of money market mutual fund shares are transaction balances. For this reason, as well as the formidable problems associated with correcting M-1B for the NOW-shift, the FOMC decided to give more weight to M-2 in assessing policy.

- Despite the problems of interpretation, the staff viewed the sluggish 1.1% rate of growth of shift-corrected M-1B during the first quarter as "extraordinary." This created a likelihood that in subsequent quarters money growth would speed up relative to growth of nominal GNP. With that in prospect, the FOMC elected to stick with its nonborrowed reserves provision targets, fully aware that the decision could well put upward pressure on interest rates.

- The minutes state more explicitly than before that under the Fed's "new-new" operating procedures (see this letter of April 17), the Federal funds rate range serves only to prompt telephone consultations; it is "not intended as a binding constraint on System operations." In fact, the telephone conference call on May 6 resulted in the 13%-18% bands then in effect being ignored, since the Committee was scheduled to meet soon anyway.

William C. Melton

Note: The full text of the letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

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Market Yields

	5/22/81 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	20.50%	19.50%	14.50%
Effective since	5/22/81		
Discount Rate at Federal Reserve Bank	14.00	14.00	13.00
Federal Funds	19.50	18.50	8.75
Repurchase Agreements	17.25	17.00	8.25
U.S. Treasury Issues			
Bills			
3 months	17.69	17.35	7.85
6 months	17.04	16.90	8.20
1 year	16.41	16.60	8.45
Coupons			
2 years	15.45	15.61	8.65
4 years	14.70	15.25	9.35
7 years	14.10	14.40	9.68
10 years	13.82	14.10	9.80
Long Bond	13.36	13.60	10.08
Negotiable Certificates of Deposit-Secondary Market			
1 month	18.50	18.80	8.45
3 months	18.55	18.80	8.50
6 months	17.50	18.10	8.40
1 year	17.00	17.30	9.00
Banker's Acceptances			
1 month	18.60	18.75	8.10
3 months	18.60	18.75	8.15
6 months	17.70	18.15	8.35
Eurodollar Deposits			
1 month	19.25	19.00	8.94
2 months	19.25	19.50	9.25
3 months	19.31	19.63	9.50
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	18.00	18.00	4.00
1 month	17.75	17.75	8.00
3 months	17.00	17.00	8.00
Bank Holding Companies			
1 month	18.50	18.50	8.25
Dealer Placed:			
3 months	19.00	18.05	8.25
New AA Corporate Utility Bond	16.00	15.75	11.50
Tax Exempt			
6 month Project Notes	7.50	7.80	4.90
1 year AAA Bond	7.50	7.50	5.00
5 year AAA Bond	8.30	8.35	5.20
20 year AAA Bond	10.10	10.10	6.75

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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